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Major Management Challenges and Program Risks

Small Business Administration

Accountability * Integrity * Reliability

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Contents

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Comptroller General
of the United States

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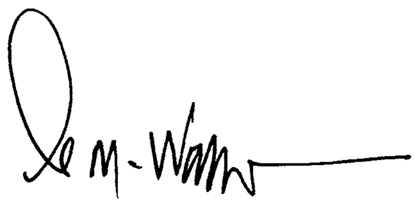
The President of the Senate
The Speaker of the House of Representatives

This report addresses the major performance and accountability challenges facing the Small Business Administration (SBA) as it seeks to aid, counsel, assist, and protect the interests of the nation's small businesses and help businesses and families recover from natural disasters. It includes a summary of actions that SBA has taken and that are under way to address these challenges. It also outlines further actions that GAO believes are needed. This analysis should help the new Congress and administration carry out their responsibilities and improve government for the benefit of the American people.

This report is part of a special series, first issued in January 1999, entitled the *Performance and Accountability Series: Major Management Challenges and Program Risks*. In that series, GAO advised the Congress that it planned to reassess the methodologies and criteria used to determine which federal government operations and functions should be highlighted and which should be designated as "high risk." GAO completed the assessment, considered comments provided on a publicly available exposure draft, and published its guidance document, *Determining Performance and Accountability Challenges and High Risks* (GAO-01-159SP), in November 2000.

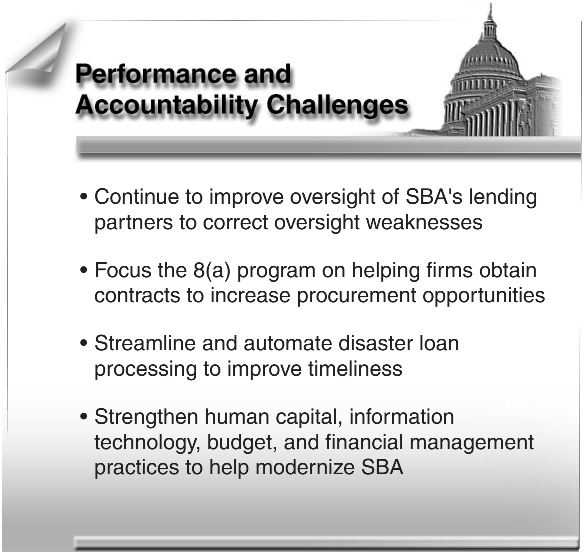
The full 2001 *Performance and Accountability Series* contains separate reports on 21 agencies--covering each cabinet department, most major independent agencies, and the U.S. Postal Service. The series also includes a governmentwide perspective on performance and management challenges across the federal government. As a companion volume to this series, GAO is issuing an update on those government operations and programs that its work identified as "high risk" because of either their greater vulnerabilities to waste, fraud, abuse, and mismanagement or major challenges associated with their economy, efficiency, or effectiveness.



David M. Walker
Comptroller General
of the United States

Overview

The Small Business Administration (SBA) is responsible for aiding, counseling, assisting, and protecting the interests of the nation's small businesses and for helping businesses and families recover from natural disasters. SBA is also a financial institution with significant commitments and exposure. As of September 30, 2000, SBA's total portfolio was about $52 billion, including $45 billion in direct and guaranteed small business loans and other guarantees and $7 billion in disaster loans. Since its inception, SBA has, among other things, made 1.1 million small business loans and has approved 1.4 million disaster loans to individual homeowners, renters, and businesses of all sizes. At the same time, SBA is confronting several major performance and accountability challenges that affect its ability to efficiently deliver services. To its credit, SBA is taking steps to address these challenges. However, many of SBA's planned improvements hinge on its multi-million dollar, three-phase systems modernization effort. At this point, it is too early to tell whether the systems modernization effort will help resolve SBA's performance and accountability challenges.



Improve Oversight of SBA's Lending Partners

SBA's oversight of its lending partners has become more important over the last decade as SBA has shifted more loan making and servicing responsibilities to private sector lenders. Private sector lenders are given authority to determine eligibility and to approve loans without prior SBA approval for over 70 percent of loans in SBA's largest lending program, the $9.5 billion 7(a) guaranteed lending program. However, in 1998, we found that SBA lacked a coordinated lender oversight program. For example, SBA's operating procedures for the 7(a) program required on-site reviews of lenders, but SBA had not consistently reviewed lenders to ensure that they were complying with its 7(a) loan policies and procedures. The lack of review increased the potential for program abuse and raised financial risks to the agency. We recommended that SBA ensure that the required 7(a) lender oversight reviews are conducted and establish organizational responsibilities and a mechanism for ensuring that information on the lender review process is collected, reported, and analyzed. SBA recognizes the need to improve its oversight of lenders and has, among other things, embarked on a systems modernization program to permit better data collection, lender oversight, and risk management and has begun regular reviews of lenders.

Focus the 8(a) Program on Contract Assistance

In the case of SBA's 8(a) business development program, we reported that most contract dollars continue to go to relatively few firms, assistance provided through the program needs to be refocused, and the program's information system does not support the program's mission. For example, in fiscal year 1998, 209 of the 6,000 firms in the program--less than 4 percent--received 50 percent of the 8(a) contract dollars, effectively limiting the developmental opportunities available to other firms in the program. In addition, we found that almost all firms joined the program to obtain 8(a) contracts, wanted SBA to provide contracting assistance, and were more satisfied with the program if they received a contract. In providing assistance, we found that SBA had emphasized business management skills rather than providing contracting assistance. SBA's information system for the 8(a) program does not meet the information needs of headquarters or district officials and SBA remains unable to track the training and assistance it provides to 8(a) firms. We recommended that SBA take several actions aimed at better meeting the purpose of the program, and the needs and expectations of the firms in the program, and improving SBA's ability to determine how well the program is working. SBA concurred with our recommendations, and has initiated some changes. However, the information systems changes that are needed will not take place until the final phase of SBA's agencywide systems modernization effort. SBA intends to begin planning activities for this phase of the modernization in 2002.

Streamline Disaster Loan Processing

SBA also needs to continue its efforts to streamline and modernize its disaster loan processing if it is to consistently provide timely assistance to disaster victims. Because its disaster-related workload varies so much over time, SBA needs to be able to quickly expand its loan processing capabilities, including hiring and training damage inspectors, loan officers, and other staff to provide consistent timely assistance. While SBA processed 91 percent of loan applications within its standard of 21 days in fiscal year 2000, performance in other years has been highly variable. Our examination of SBA loan processing statistics for fiscal years 1997-2000 showed, on average, that (1) SBA was able to process loans for homes and personal property more quickly than loans to businesses, and (2) loan volume did not impact processing time. SBA officials said that because business loans are more complicated than home loans they often take longer to process, but loan processing times in general are lengthened by SBA's paperwork-intensive process. In June 2000, SBA began using an expedited system that streamlines processing of certain home and personal property loans. As part of its agencywide modernization efforts, SBA is in the midst of a larger project to reengineer loan processing overall, including increased use of automation, but as with the rest of SBA's systems modernization effort, significant work remains to be done.

Modernize SBA

As SBA continues to modernize itself, our work shows that SBA needs to identify and address human capital,[1] information technology, and budgetary and financial accountability challenges that have agencywide

[1]SBA's human capital concerns can be seen as part of a broader pattern of human capital shortcomings that have eroded mission capabilities across the federal government. See our *High Risk Series: An Update* (GAO-01-263, Jan. 2001) for a discussion of human capital as a newly designated governmentwide high-risk area.

implications. Although SBA has begun to take steps for better managing its human capital activities, such as undertaking various workforce planning activities and realigning and deploying some staff, our work shows that more needs to be done. SBA needs to (1) complete its efforts to identify the knowledge, skills, abilities, and other characteristics that its employees will need to perform successfully in SBA's new business environment; (2) estimate the number of employees with those skills who will be needed; (3) develop a succession plan for senior leaders; and (4) ensure that employees receive adequate training to do their jobs well. Absent addressing these issues, SBA's attempt to redesign its business processes and transform its workforce is potentially at risk. SBA also recognizes the limitations of its current information system and has embarked on an agencywide systems modernization initiative, but our work has shown that SBA needs policies and procedures to control key information technology processes. To improve SBA's information systems management, we recommended that SBA establish policies and procedures for managing information technology and define and implement processes in the areas of investment management, information technology architecture, software development and acquisition, information security, and information technology human capital management. SBA said that efforts are underway to address our recommendations and has stated that it is committed to improving its information technology management practices.

SBA's lack of integrated budget, accounting, and performance information systems hinders the use of spending and performance information to address performance issues. As a result, SBA cannot track its spending by agency goal and managers must create their own spreadsheets to reconcile actual to planned spending. SBA is developing an activity-based accounting structure to link costs to activities, outputs and goals. SBA also plans to begin implementing an integrated budget, accounting, and performance information system beginning in October 2001, but has not yet determined how it will use the performance information capabilities of the new system.

While SBA has made major strides in improving its financial management, as evidenced by its unqualified audit opinion on its fiscal year 1999 financial statements, the agency still faces major challenges to achieving financial accountability. Two material internal control weaknesses were identified in SBA's fiscal year 1999 financial statement audit: (1) SBA's financial reporting process did not ensure that its financial statements were free of material misstatements and (2) general computer control weaknesses in SBA's information systems meant that SBA could not ensure that unauthorized activities, such as the modification of data or software, would be prevented or detected. SBA hopes to resolve these challenges through the second phase of its systems modernization effort, scheduled for completion in fiscal year 2003. It is too soon to tell whether the modernization will resolve SBA's noncompliance.

Major Performance and Accountability Challenges

SBA was created almost 50 years ago to help ensure a strong and vibrant small business sector. SBA, along with other federal agencies, also helps businesses and families recover from natural disasters. As a voice for small business, SBA represents the nation's millions of small businesses that collectively employ 53 percent of the private nonfarm workforce. SBA provides small businesses with access to credit, primarily by guaranteeing loans through its 7(a) program. SBA also administers the 8(a) business development program, which is designed to assist small disadvantaged businesses in obtaining federal contracts. SBA provides entrepreneurial assistance through partnerships with private entities that offer small business counseling and technical assistance. SBA also makes loans to businesses and families trying to rebuild in the aftermath of a disaster. SBA's mission of helping the nation's small businesses to succeed, as well as its role as a financial entity with a total loan and loan guarantee portfolio of about $52 billion, makes its performance and accountability challenges important to the nation as a whole.

As with other agencies and departments, problems that we have found at the SBA agencywide level in specific areas such as human capital and information technology, are also found at the program level and contribute to SBA's difficulties in effectively meeting its mission. SBA's solution to many of its current problems hinges on its information systems modernization effort. It is too soon to tell how much the modernization effort will help solve these problems.

Continued Oversight Improvements of SBA's Small Business Lending Partners Are Key to Mitigating Risk to the Agency

SBA's need to oversee its lending partners has become more important over the last decade as SBA has shifted more loan-making and servicing responsibilities to private sector lenders. For the 7(a) program, SBA's largest lending program and its primary vehicle for providing small businesses with access to credit, SBA used to review the creditworthiness of each loan applicant and participate in the servicing and liquidation of each loan that went into default. However, as SBA's workforce has decreased and its loan portfolio has increased, SBA has sought to modernize its operations by relying more on the private sector. Private sector lenders are given authority to determine eligibility and approve loans without previous SBA approval for over 70 percent of the 7(a) loans.

As part of its July 31, 1999, business process reengineering study, a private firm hired by SBA reported that SBA did not have a coordinated lender oversight system.[1] Although a number of processes were in place, not all were consistently administered throughout the organization. The study stated that SBA required that the field offices review lenders, but there was no method of tracking the review process or the number of reviews completed. In addition, a majority of the lenders were not required to renew their lending authority within a given time frame because their right to participate did not expire. The lack of review increased the potential for program abuse and raised SBA's program risk, according to the study.

[1] Business Process Reengineering of the Office of Capital Access/Financial Assistance Loan Monitoring Programs; Booz, Allen & Hamilton (July 31, 1999).

In our 1998 review, we found that few reviews of lenders had been conducted. Despite operating procedures requiring periodic reviews, about 96 percent of the lenders had not been reviewed in the prior 5 years–1993 through 1997–in the five district offices we visited. In addition, we found that SBA's Inspector General–who is required to conduct periodic audits of Small Business Lending Companies under SBA regulation–had conducted audits at only 3 of the 12 Small Business Lending Companies that were operating as preferred lenders at that time.[2] Without such systematic oversight, SBA could not ensure that participating lenders were complying with its loan standards, thereby mitigating risks to the agency. In addition, SBA did not have clear organizational responsibilities and mechanisms in place to ensure that information on the lender review process was collected, reported, and analyzed. Without such information, SBA could not measure and monitor the impact of its oversight of lenders' compliance with its loan policies and procedures. In 1998, we recommended that the Administrator of SBA ensure that the required 7(a) lender oversight reviews are conducted and establish organizational responsibilities and a mechanism for ensuring that information on the lender review process is collected, reported, and analyzed. We also recommended that the Administrator develop and implement a mechanism to satisfy its supervision and examination function for Small Business Lending Companies.

In response to our recommendations, SBA has begun regular reviews of lenders, and created an Office of Lender Oversight. As of March 2000, SBA had completed two annual compliance reviews of its preferred lenders and had begun implementing a review

[2] Small Business Lending Companies are nondepository institutions licensed by SBA that are not subject to state or federal supervision or examination other than oversight conducted by SBA.

program for other lenders. SBA has also contracted with the Farm Credit Administration for safety and soundness examinations of Small Business Lending Companies. In addition, SBA created and is in the process of staffing an Office of Lender Oversight. SBA has also embarked on the creation of a loan monitoring system as part of the first phase of its overall systems modernization. The purpose of the loan monitoring system is to permit better data collection, analysis and evaluation of loans, and lender and program performance. In April 2000, we provided SBA with a list of 13 recommendations to help SBA complete the eight planning actions mandated for its loan monitoring system and to strengthen SBA's information technology practices. In general, the recommendations covered the completion of work for planning actions and the implementation of key functions, such as quality assurance and system security, to effectively manage the development of the system. SBA is in the process of implementing each of these recommendations.

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SBA Could Better Focus Its 8(a) Program to Help Firms Obtain Contracts

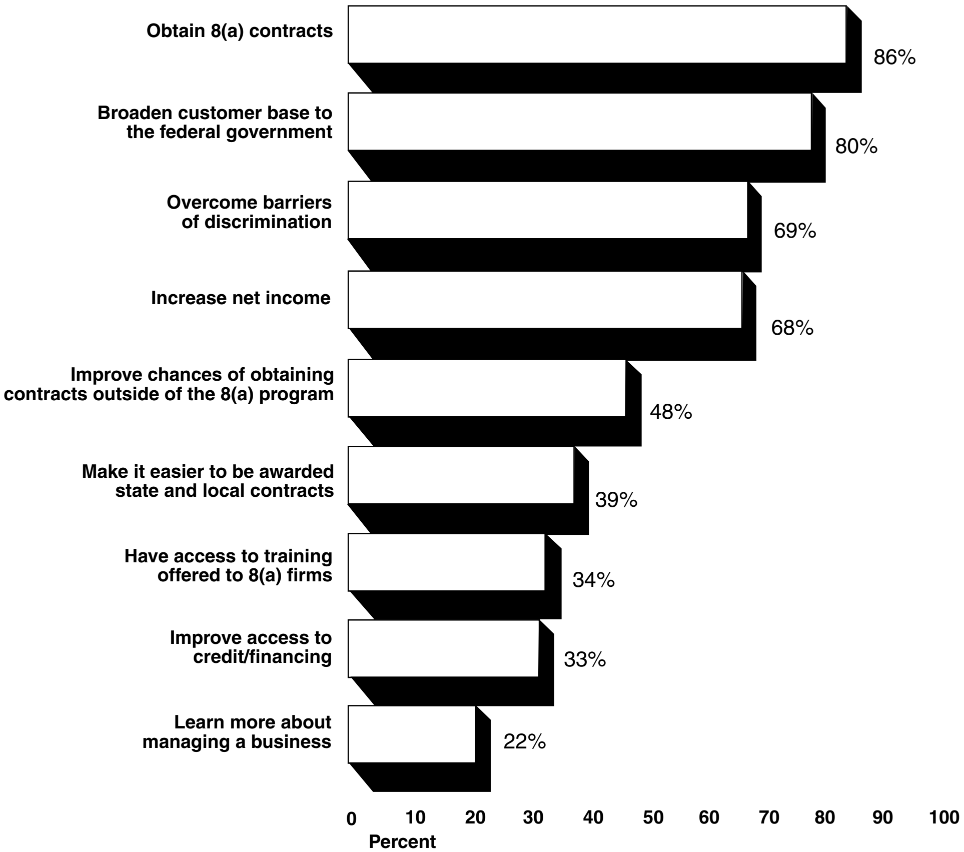
As we reported in July 2000, firms' access to 8(a) contracts—long considered the program's biggest benefit—remains a problem. A long-standing concern cited in our previous reports and those of the SBA Inspector General is that relatively few firms receive most of the 8(a) contracts, effectively limiting the developmental opportunities available to other firms in the program. For example, in fiscal year 1998, although there were over 6,000 firms in the program, 209 firms received 50 percent of the 8(a) contract dollars and over 3,000 firms did not receive any contracts. Although SBA acknowledges this problem and has made some changes to the program to address it, SBA officials said that because of differences in firms' skills and experiences and other factors, it is reasonable that not all 8(a) firms receive contracts from the program. In addition, SBA relies on other federal agencies to make the contract awards, and federal procuring officials are confronted with the competing objectives of accomplishing their agencies' missions at a reasonable cost and achieving the 8(a) program's business development goals.

Yet, our survey of 1,200 8(a) firms[3] showed that SBA needs to refocus the assistance it provides to firms in the program from business management training to federal contract proposal and marketing strategies. As shown in figure 1, our survey demonstrates that almost all of the firms joined the program to obtain 8(a) contracts and wanted SBA to provide contracting assistance. We found that 8(a) firms were more satisfied with the program if they had received a contract. One reason that firms did not place a high priority on learning to manage a business was because a large majority of the firms had owners with over 10 years' experience in managing a business. In addition, the firms themselves were not new; over half the firms we surveyed had been in business 5 years or more before joining the program. We found that firms that have owners with less management experience are not as likely to obtain 8(a) contracts as firms with more experienced owners. Yet, we found no significant

[3] We surveyed 1,200 firms randomly selected from SBA's database of 5,432 active firms. The survey response rate was 71 percent and the results can be generalized to the entire population of active 8(a) firms as of September 30, 1999.

relationship between the amount of time a firm has been in business before joining the program and success in obtaining a contract. In providing assistance, we found that SBA had emphasized business management skills rather than providing contracting assistance and had not targeted its business management skill training to firms with owners having less management experience.

Figure 1: Major Reasons That Firms Joined the 8(a) Program



Source: GAO survey.

In addition, in our July 2000 report, we found that SBA's 8(a) information system, while intended to be a comprehensive tool enabling SBA to monitor the program, does not meet the information needs of headquarters or district officials. Potentially useful information, such as the amount of training and assistance provided for participating firms, is not captured as part of SBA's information-gathering process. This limits SBA's ability to assess whether its efforts had an impact on the ultimate performance goal of creating commercially viable and stable firms. The system is so difficult to use that most of the district offices we visited had devised other methods—including maintaining redundant local systems—to obtain the information they needed in a timely fashion. Although program officials have recognized the need to update the system since 1996 and have planned update efforts, none of them resulted in substantial progress in improving the information system. The primary reason for this, according to program officials, is that leadership changes have contributed to an environment in which progress on the information system has languished. During the 4-year period from March 1996 to March 2000, the office under which the program is managed has been led by five different Associate Deputy Administrators. SBA plans to update the 8(a) information system as part of the final phase of its agencywide systems modernization effort. Planning for this phase is scheduled to begin in 2002. In the meantime, SBA has begun to develop a strategic information technology plan for the 8(a) program that combines and updates recommendations from the agency's earlier business process reengineering studies.

We recommended that SBA take several actions aimed at better meeting the purpose of the program, and the needs and expectations of the firms in the program, and improving SBA's ability to determine how well the program is working. These included instructing district offices to place their highest priority on helping inform firms about contracting opportunities; periodically performing a nationwide survey of 8(a) firms to obtain measurable program data; and designing an integrated 8(a) information system. SBA concurred with our recommendations and is in the process of implementing them. For example, SBA is developing district office goals for fiscal year 2001 to encourage the offices to help more 8(a) firms obtain contracts. However, implementation of a number of our recommendations will not occur until the final phase of SBA's system's modernization initiative. SBA expects to begin planning activities for this phase of the modernization in 2002.

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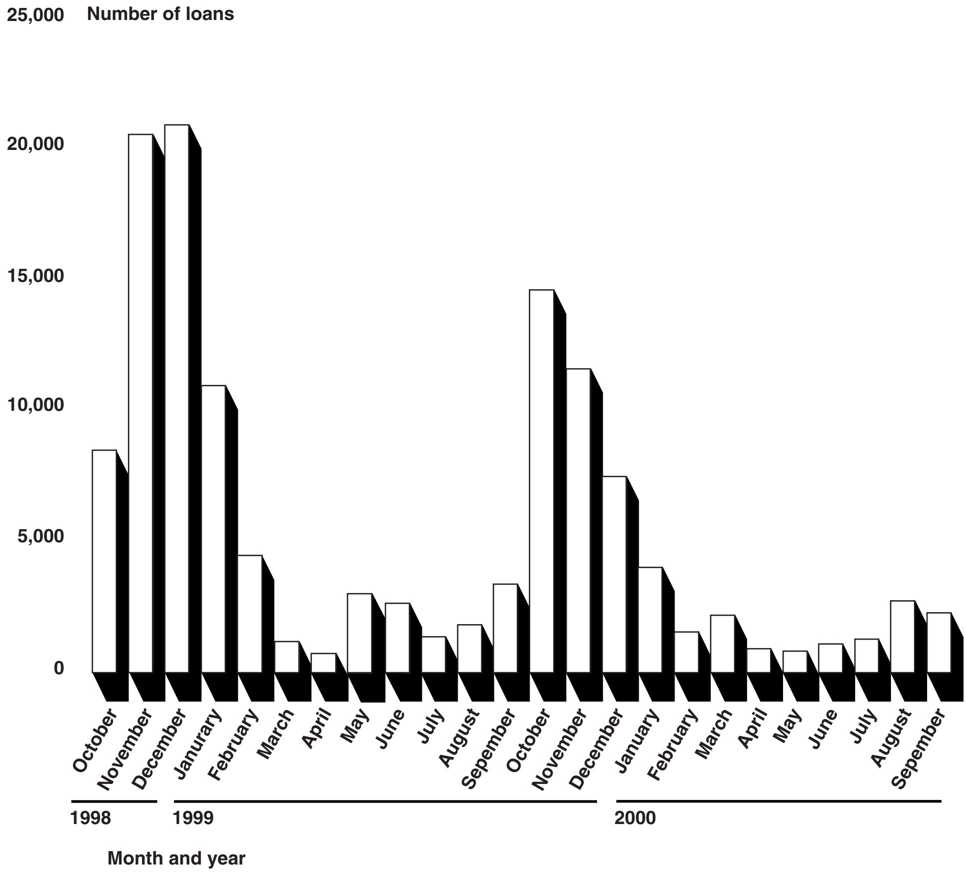
Modernization May Improve SBA's Disaster Loan Processing Timeliness

SBA's efforts to streamline and modernize its disaster loan processing may help it to consistently provide timely assistance to disaster victims. SBA is one of many federal agencies responsible for assisting disaster victims. SBA's Office of Disaster Assistance makes loans directly to (1) households to repair or replace damaged homes and personal property, and (2) businesses to recover from both disaster-caused physical damages and economic losses. The Disaster Loan Program is SBA's largest direct loan program and the agency's only assistance that is not limited to small businesses. At the end of fiscal year 1999, SBA had almost $7 billion in disaster loans in its portfolio. In fiscal year 1999, SBA made 29,000 loans to rebuild homes and 7,400 loans to rebuild businesses.

Disasters are inherently unpredictable; therefore, the need for SBA disaster assistance is unpredictable as well. SBA faces a significant challenge in its responsibility to provide consistent and timely assistance to households and businesses recovering from disasters. Because its disaster-related workload varies so much over time, SBA needs to be able to quickly expand its loan processing capabilities, including hiring and training damage inspectors, loan officers, and other staff to respond to the times when it is handling many applications for assistance at once. Figure 2, shows the number of disaster loan applications that SBA processed per month in fiscal years 1999 and 2000.[4]

[4] The SBA statistics used in this report include only approved and denied loan applications. These figures do not include withdrawn applications i.e., those in which an applicant chose not to complete the application process.

Figure 2: Disaster Loans Processed in Fiscal Years 1999 and 2000, by Month



Source: GAO analysis of SBA data for approved and denied loan applications.

One of SBA's standards for disaster response timeliness is that the agency should establish a field presence within 3 days of a disaster declaration. This generally entails placing SBA staff in the Disaster Recovery Centers and Disaster Field Offices opened by the Federal Emergency Management Agency.[5] These SBA staff help provide information about disaster recovery assistance by briefing the media and state and local officials, taking calls from people seeking information about SBA loans, and providing assistance with loan applications. SBA reported that it met its 3-day field presence standard 100 percent of the time during fiscal years 1999 and 2000. SBA officials attribute their success in meeting this standard to close coordination with the Federal Emergency Management Agency. Federal Emergency Management Agency officials in both headquarters and the field told us that coordination between their agency and SBA is very good. In addition, emergency management officials we contacted in California, Colorado, New Mexico, Texas, Utah, and West Virginia also believed that SBA response to disasters in their states had been timely and effective.

A second SBA timeliness standard is to process loan applications within 21 days of receipt.[6] An SBA official said that it has been difficult to set a goal for the percentage of loans it will process within its 21-day standard. SBA's goal was originally set based on performance during the previous year and was then adjusted as performance changed. For example, because SBA processed almost 90 percent of its loans within 21 days in 1997, the initial goal was set at 90

[5] The Federal Emergency Management Agency has the lead responsibility for the federal response to disasters.

[6] Processing loan applications includes inspecting physical damages to ensure that only disaster-caused damages are to be repaired or replaced, determining applicants' creditworthiness, and making the loan approval decision.

percent. When SBA's success dropped to 77 percent in fiscal year 1998 and 64 percent in fiscal year 1999, the goal was reduced to 70 percent. However, the goal was increased to 80 percent in SBA's strategic plan for fiscal years 2001 through 2006 because of indications that fiscal year 2000 performance had improved. In fiscal year 2000, SBA met its 21-day processing standard 91 percent of the time. Table 1 shows timeliness statistics for fiscal years 1997 through 2000.

Table 1: SBA Disaster Assistance Loan Processing Times, Fiscal Years 1997 – 2000

Fiscal year	Number of loans processed	Average processing time (days)	Percentage of loans meeting 21-day standard
1997	91,929	12.6	89.8
1998	62,259	15.6	76.6
1999	79,301	22.0	63.6
2000	50,360	13.0	91.4
Four year average, fiscal years 1997-2000	70,962	15.9	79.9

Source: GAO analysis of SBA data for approved and denied loan applications.

We analyzed SBA loan processing data to determine what factors may have affected loan processing times. We found three factors that appeared to influence processing time, while a fourth did not:

- As loan amount increases, loan processing time tends to increase. During fiscal years 1997 through 2000, the average processing time increased consistently as loan dollar amount increased.
- Business loans took longer to process on average than home and personal property loans.

- Approved loans took somewhat longer to process on average than denied loans.
- The volume of loans an office processed did not appear to influence timeliness. Our analysis of SBA's monthly loan processing data showed no relationship between the number of loans processed in a given month and the average number of days it took to process the loans.

SBA officials told us that some of these processing time differences can be explained by variations in the steps that have to be followed for different loan applications. For example, on average, it takes longer to approve a loan than to deny one because processing stops as soon as the denial decision is made by SBA, while approved loans have processing steps remaining. Also, business loans often take longer to process than home and personal property loans because loan officers making business credit decisions have to consider additional factors for businesses. According to SBA, this may also explain, in part, the longer average times for higher dollar value loans, because business loans tend to be for larger amounts.

SBA officials acknowledged, however, that loan processing times are also lengthened by a paperwork-intensive process. For example, loss verification inspectors make their inspection reports on paper documents that they have to carry back to a Disaster Field Office for processing. In contrast, inspectors from the Federal Emergency Management Agency use a transmittable, electronic form on hand-held computers. Also, few of the steps followed by SBA loan officers are automated, according to area office officials, and this lack of automation increases processing times.

SBA has efforts under way to speed up its loan processing. In June 2000, the agency implemented a streamlined process for approving original home and personal property loans of $25,000 or less. An area office official told us that this process is much faster than the standard process, with 1-day loan approval decisions possible for loan applications that include all of their documentation. SBA is also engaged in an examination of loan processing in general, with the goal of creating automated processes for home and business loans. SBA needs to meet this goal of modernizing its loan processing if it is to consistently meet its timeliness goals. However, as with the rest of SBA's system modernization effort, significant work remains before SBA is ready to implement a new loan processing system. SBA has also used a customer survey, in part, to identify and address loan processing problems. We noted, however, that this survey only included successful loan applicants. Future surveys would be more useful if they were to include applicants whose loans were denied.

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Human Capital, Information Technology, and Budget and Financial Accountability Need to Be Strengthened

SBA has developed a vision of a "modernized SBA," increasing opportunities for small businesses, but more needs to be done in the human capital, information technology, budget and financial management areas. SBA has communicated its vision in its various strategic planning documents prepared in accordance with the Government Performance and Results Act of 1993. As we reported in September 2000, once an organization has defined and communicated its vision, the organization should design a framework of human capital policies, programs, and practices to steer the organization toward achieving that vision. In the past few years, as SBA's business approach has been changing, the agency has begun to take steps for better managing its human capital activities, including activities in workforce planning, leadership, talent, and performance culture, to meet this challenge. For example, recognizing that in some geographic areas it had too many or too few employees or employees that lacked specific knowledge or skills, SBA contracted for the development of a staffing and resource model to realign and deploy its current district office staff. Using the results of the model, SBA recently initiated a relocation and reassignment program to fill vacancies.

We reported in July 2000, that more remained to be done in the human capital area at SBA. Absent addressing these issues, SBA's attempt to redesign its business processes and transform its workforce is potentially at risk. For example, SBA had not used its staffing model to project future staffing requirements because it lacked information on the average time it took to perform certain tasks. As a result, the agency's realignment efforts were limited to allocating staff to accomplish the current workload. In addition, SBA may not have the appropriate complement of leaders it will need because it had not performed succession planning. SBA was also faced with the challenge of improving on 1999 survey results which indicated that fewer SBA employees believed they had received adequate training to perform their jobs than did employees in 14 departments and 8 independent agencies included in the survey. As of October 2000, SBA said that it has initiated several succession planning efforts. For example, SBA had identified a group of 7 District Director candidates and was training them, was selecting candidates for its Senior Executive Service candidate development program, and had decided to support 10 Presidential Management Interns. SBA had also requested additional training funds and had developed a training curriculum for reengineered business practices that will be targeted widely to over 1,000 field and headquarters staff. Sustained attention to these issues will be important as SBA continues to implement its new business processes and realign its human capital policies and practices to support those new processes.

Although SBA plans to improve its key information technology processes, at the time of our May 2000 review many of SBA's policies and procedures for managing information technology were in draft form or not yet developed and current practices did not generally adhere to accepted industry standards. Specifically, SBA had not yet established policies to manage information technology investments and human capital. Although standards and procedures to support new software development were being adopted, information technology guidance on software acquisition was obsolete. Procedures for maintaining SBA's agencywide information technology architecture and for implementing information security policies were in draft form and incomplete. Investment management activities were limited largely to reviewing information technology proposals and architecture-related activities were performed without a defined process. Human capital management activities were limited to a non-information technology specific training needs survey, and a human capital assessment had not been performed to identify short- and long-term information technology knowledge and skills requirements. Software development and acquisition practices were predominantly ad hoc. Security assessments had not been performed periodically on all mission-critical systems, and security training had not been provided to employees and contractor staff.

Without established information technology management policies and defined processes, SBA cannot ensure that consistent selection criteria are used to compare project proposals, effective guidance is provided to efforts to migrate systems and make them interoperable, key activities are consistently performed when project managers are faced with time constraints or limited funding, the knowledge and skills needed to support its information technology management mission are identified, and critical information and assets are protected from inappropriate use. To improve SBA's information systems management, we have made a number of recommendations that SBA has agreed with. SBA has stated that efforts are underway to address them and has stated that it is committed to improving its information technology management practices.

SBA has made some progress in integrating performance management into its budget formulation and initial resource allocation processes, but the agency has not tracked spending according to goals because budget and accounting systems are aligned with SBA's organizational structure rather than by strategic goal. For its fiscal year 2001 budget request, SBA took steps to link its budget formulation and performance management processes. Yet, no clear link exists between past performance and requested funding levels for fiscal year 2001. Furthermore, although SBA reviewed the resources needed to maintain existing programs in fiscal year 2001, this review did not take into account planned fiscal year 2000 spending that was not likely to recur in fiscal year 2001. After allocating funds for personnel–which make up about 75 percent of SBA's operating costs–and other relatively fixed expenses, such as rent, SBA structured the initial allocation of fiscal year 2000 funding for "other operating expenses" around achieving agency goals. This process is not used for subsequent allocations arising from unforeseen expenditures and changes in planned obligations. SBA lacks such a structure to address changing priorities during the fiscal year.

SBA's use of spending and performance information to ensure results is hampered because financial systems are not aligned with agency goals. For fiscal year 2001, SBA has begun using activity-based costing software to link costs to activities, outputs, and goals. SBA officials said they anticipate using this information to compare unit costs of loan activities within the agency. In addition SBA's financial and related systems are not integrated or user friendly and, as a result, program-level financial managers create their own spreadsheets to reconcile actual to planned spending. To improve integration of its financial and performance information systems and reporting, SBA plans to begin implementing an integrated system beginning in October 2001. However, SBA has not yet determined how it will use the performance information capabilities of the new system.

While SBA has made major strides in improving its financial management, as evidenced by its unqualified audit opinion on its fiscal year 1999 financial statements, the agency still faces major challenges before it can fully achieve financial accountability. Two material internal control weaknesses were identified in SBA's fiscal year 1999 financial statement audit: (1) SBA's financial reporting process did not ensure that its financial statements were free of material misstatements and (2) general computer control weaknesses in SBA's information systems meant that SBA could not ensure that unauthorized activities, such as the modification of data or software, would be prevented or detected. SBA's lack of an integrated general ledger for recording its transactions during the year contributed to the deficiencies in SBA's financial reporting process. SBA used three separate accounting systems to record various types of transactions. In addition, SBA relied on multiple, nonintegrated spreadsheets as well as complex and error-prone manual processes for recording financial data.

This resulted in an overly complex process for preparing financial statements and a lack of assurance about the reliability of data. In addition, SBA lacked comprehensive plans and procedures for preparing its financial statements. Although SBA took significant, positive steps in fiscal year 1999 toward improving the general computer controls over its financial management systems, the results of the audit showed that significant deficiencies continued to exist. SBA's auditors found deficiencies in all six of the general computer control categories that are included in the audit process. For example, 11 percent of active users' accounts in SBA systems were for employees and contractor personnel no longer employed by the agency. These user accounts were not inactivated promptly upon termination or transfer of an employee. General computer controls have an impact on the overall effectiveness and security of computer operations rather than on specific computer applications. In addition, they create the environment in which application systems and controls operate. SBA's control weaknesses increased the risk of unauthorized access to data and software, and reduced assurance that the unauthorized activities would be prevented or detected.

The deficiencies in SBA's financial reporting process, coupled with its general computer control deficiencies, resulted in SBA's lack of substantial compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA). FFMIA is a measure of an agency's ability to incorporate into its financial management system accounting standards and reporting objectives established for the federal government, so that all assets, liabilities, revenues, expenses, and the full costs of programs and activities can be consistently and accurately recorded, monitored, and uniformly reported. Substantial noncompliance with FFMIA indicates that agency financial management systems do not routinely provide reliable, useful, and timely financial information to manage on a day-to-day basis. SBA's overall strategy to resolve its FFMIA noncompliance hinges on its systems modernization effort. Preliminary planning for the second phase of this project, which will address FFMIA noncompliance, started in fiscal year 1998. It is too soon to tell whether the system modernization effort will resolve SBA's noncompliance.

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